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Victim v. Victim Restitution: The Commingling Fictions

Andrew Kull
University of Texas at Austin

ARTICLE

VICTIM V. VICTIM RESTITUTION: THE COMMINGLING FICTIONS

ANDREW KULL*

I. INTRODUCTION

Standard restitution involves the unjust enrichment of a defendant at the expense of a plaintiff, making the overall thrust of the remedy (if not its precise shape and extent) reasonably clear. Cases of successive frauds—in which Swindler defrauds first A, then B, then C—do not fit the usual profile. Swindler has no assets with which to meet his many liabilities—any property in his hands belongs to his victims—so he is out of the picture. The

* Distinguished Senior Lecturer, University of Texas School of Law; Reporter, Restatement Third, Restitution and Unjust Enrichment. Portions of this article appeared in different form in Andrew Kull, *Defences to Restitution Between Victims of a Common Fraud, in* Defences in Unjust Enrichment 229–54 (Dyson et al. eds., 2016). The author is indebted to Samuel Bray, Ward Farnsworth, Daniel Friedmann, Launcelot Henderson, and Calvin Johnson for pertinent comments and suggestions.

Swindler's victims, however, may have restitution claims against each other. Swindler might have repaid A with funds obtained by fraud from *B*, or even persuaded B to repay A directly. Does B have a claim in restitution against A to get this money back? Defendants in these cases will deny that they have been enriched at the expense of the plaintiffs in anything like the normal way: they will describe themselves instead as fellow victims of an absent wrongdoer—survivors of a common casualty. Instead of the claims and defenses used to work out justice in standard restitution scenarios, justice between fellow victims tends toward a rule of share and share alike.

The contemporary setting of the problem, and the place where some new law is being made, is in the aftermath of a Ponzi scheme. Numerous victims have delivered money, securities, or other property to Swindler, and there are some assets on hand that are clearly the product of the fraud. Accounts have been frozen, a receiver has been appointed, and the question is how to distribute whatever it is possible to marshal. Because everything within reach of the receiver is property obtained by fraud from one victim or another, allocating the assets in receivership means deciding restitution claims—whether individual or collective—between the victims *inter se*.

Everyone accepts the idea that the distribution should be "equitable"; that "equality is equity"; and that equal distribution in this context means "ratably in proportion to losses"—a rule of no priority between fraud victims, and a rule so intuitive it is scarcely perceived as a rule. That leaves the question of how the victims' losses should be measured. Established rules of property and restitution start from "net losses," determined *ex post*, once the music stops and the facts come to light. The more recent intuition of judges (and their receivers) is that the victims' relative entitlements should be based on what they originally lost—their initial investments—not on how things ended up.[1]

The choice between net losses and original investments as the basis of allocation can lead to very different outcomes. Assume that each of several victims has made a one-time investment of $1,000. So far, they are all identically situated. But their *ex post* net losses will vary significantly in any case in which (i) an investor has previously received any return of that investment, such as by dividend or withdrawal; (ii) an investor is able to identify and reclaim specific assets in the hands of the receiver, or both.

1. I described this recent development in an earlier essay, combining an account of the principal decisions with speculation about their motivation. *See* Andrew Kull, *Ponzi, Property, and Luck*, 100 IOWA L. REV. 291, 303–04 (2014).

Standard property rules dictate that either circumstance reduces net loss by allowing the fortunate victim to recoup some of what was given up. In the first instance, repayments to defrauded investors may be retained by them, free of the claims of fellow victims, because the repaid victims are allowed an affirmative defense to restitution as bona fide payees. In the second, misappropriated property that remains identifiable may be retaken by its defrauded owner from anyone not qualifying as a bona fide purchaser. Taking net loss as the basis of comparison thus means that claimants who began on an equal footing—as victims of the same fraud to which they contributed identical amounts—may have suffered unequally as a result of circumstances that are essentially fortuitous. Traditional rules about net loss accept the fact that some fraud victims may be luckier than others. By contrast, allocating losses in proportion to original investments—a rule of share and share alike—disregards or overrides both the circumstances and the legal rules that produce a disproportionate incidence of loss.

If our current sense of equity between fraud victims requires that the benchmark for ratable distribution be shifted from net losses to original investments, two important rules of law will have to be overcome or ignored. The first major obstacle is the affirmative defense allowed to a "creditor/payee" (one who receives money in satisfaction of a preexisting debt) to whom payment is made with money to which a third person would otherwise have a valid claim in restitution—such as money obtained from that third person by fraud. This defense is one branch of the standard net loss calculation because it is what permits a Ponzi victim to retain any funds he has been fortunate enough to withdraw from the scheme before it collapses—even when it is clear that such withdrawals were necessarily funded from the investments of subsequent, less-fortunate victims.

The second obstacle to be overcome is an even more basic rule of equity: the idea that an owner from whom property has been obtained by fraud may retake it, so long as it can be identified, until it comes into the hands of a bona fide purchaser. The residue of a Ponzi scheme, coming into the hands of a receiver, sometimes includes assets (such as goods or registered securities) that are easily recognizable as identifiable property of one of the victims. Meanwhile, other victims of the same fraud, who parted with just as much, are unable to identify any of their property in the wreckage of the scheme. Orthodoxy returns identifiable property to its fortunate owners, necessarily reducing their net loss from the fraud and increasing the net loss of their fellow victims—by diminishing the assets available for ratable distribution. Whether or not this seems fair depends on the scope we are willing to accord to chance and luck in human affairs. A court that condemns a net loss comparison on the ground that it is "merely fortuitous" must find a way around the owner's ordinary right to reclaim his own property.

One of the most prominent features of restitution remedies is the "tracing fictions." These are longstanding equitable rules that displace the legal logic of ownership to do justice in particular cases. Specifically, the rules allow a claimant to "trace" (or identify and reclaim) property that is no longer identifiable in fact—because it has been combined or "commingled" with other property, making it impossible to say who owns what. Recent Ponzi decisions displace ordinary property rules in the same way, but in the opposite direction. Confronted with a situation in which property is in fact identifiable, and where recognition of individual ownership results in perceived injustice, courts have treated the property as if it were commingled. Commingled property of fraud victims—uncontroversially—is subject to ratable distribution between them. Disregarding the owner's right to retake *identifiable* property requires that a lot of existing law be altered or ignored, but fictional commingling possibly does no more violence to ordinary property rules than fictional tracing.

The effect of a receiver's intuition about the equitable distribution between Ponzi victims is to adjudicate what is implicitly a restitution claim by one fraud victim against another. Claims of this kind present, in acute form, a fundamental, unanswered question about the defenses to restitution claims generally. Between innocent parties, to what extent should a liability in restitution depend on the "balance of equities" between them, as opposed to a more easily administered rule of thumb? Centuries of authority might be cited for a rule that money paid by mistake is subject to restitution, except where the recipient has been led to change position on the strength of the payment—thereby making restitution inequitable. Inescapable conflicting authority treats the recipient as a bona fide purchaser of the money—and hence immune to liability—if the mistaken payment was taken in satisfaction of a preexisting debt. Such a rule of thumb offers unmistakable advantages, but there are cases in which the equities of the parties demand closer attention. How to identify those cases is the unanswered question, but cases of restitution between fraud victims appear to be among them.

II. THE CREDITOR/PAYEE AS PURCHASER FOR VALUE

Restatement (Third) Restitution and Unjust Enrichment describes in unqualified terms an affirmative defense for the "bona fide payee," alias "bona fide creditor." According to both the newer *Restatement* and its 1937 predecessor, a payment that would otherwise be subject to restitution—typically, because the payor has been the victim of fraud or mistake—may be retained by the payee if it was taken, without notice, in satisfaction or reduction of a valid obligation.[2]

The near-immunity of the creditor/payee to a liability in restitution is the product of two related developments. The first is the expansion of the doctrine of bona fide purchase that was brought about by extending the range of what would count as "valuable consideration" (or "value," for short) in the transaction by which a purchaser acquired the property in question. In the traditional, equitable version of the rule, it was doubtful that "value" was given when property was taken in discharge of an antecedent (pre-existing) indebtedness, and taking property merely as *security* for an antecedent debt was almost certainly *not* a purchase for value. The question was salient in a single specialized context: that of transactions in negotiable instruments. In this quintessentially commercial setting, doubts about the status of antecedent debt as value were gradually overridden: first by the weight of 19th-century judicial authority, later by statute. The controversy in its judicial phase produced a sanguinary conflict between U.S. jurisdictions over what was then perceived as a question of high principle. In its statutory resolution—initially by the Negotiable Instruments Law of 1896 and, ultimately, by the Uniform Commercial Code[3]—questions of high principle were paved over and rendered invisible. Our persistent lack

2. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 67 (AM. LAW INST. 2011); *cf.* RESTATEMENT OF RESTITUTION § 14(1) (AM. LAW INST. 1937). ("An assignee of a non-negotiable chose in action who, having paid value therefore, has received payment from the obligor is under no duty to make restitution although the obligor had a defense thereto, if the transferee made no misrepresentation and did not have notice of the defense.").

3. The traditional problem areas in the definition of "value," described in the text, were eliminated by the U.C.C. for transactions within its scope. According to U.C.C. § 1-204, "a person gives value for rights if the person acquires them . . . (2) as security for, or in total or partial satisfaction of, a preexisting claim; . . . or (4) in return for any consideration sufficient to support a simple contract." U.C.C. § 1-204 (AM. LAW INST. & UNIF. LAW COMM'N 2018). For transactions in negotiable instruments—as an exception to this general definition—U.C.C. § 3-303(a)(1) retains the traditional rule by which a promise constitutes value only to the extent the promise has been performed. U.C.C. § 3-303(a)(1) (AM. LAW INST. & UNIF. LAW COMM'N 2002).

of certainty about equity between competing fraud victims is a hint of unresolved problems lying beneath the surface.

The second concurring development was the decision by Warren Seavey and Austin W. Scott, reporters of the original *Restatement of Restitution*,[4] to adopt the commercial rule about antecedent debt for cases in which a claimant's money or property had been transferred, as a result of fraud or mistake, to an innocent creditor/payee.[5] This was itself an important extension of the commercial rule, since cases of fraud and mistake within the *Restatement* included many situations beyond the scope of the uniform laws and outside the U.C.C. even today. In their accompanying reporters' notes, Seavey and Scott acknowledged that the rule they called "discharge for value" might not do justice in cases where money of one fraud victim was used to repay another, but they announced that equities between the victims in such cases were irrelevant.[6]

It is in precisely these cases of victim v. victim restitution that the blanket defense afforded to a creditor/payee against a liability in restitution—prefigured by the commercial rules about antecedent debt as value, endorsed by both *Restatements of Restitution*—has most often been questioned. A perceptible sense that the rule does not do justice between fraud victims is explained by the derivation of the modern doctrine. Purely equitable in its inception, the defense of purchase for value hardened and crystallized as it was applied to commercial transactions in which finality and predictability were felt to be more important than any balance of equities between the parties. However, when it comes to be applied to transactions as far outside the ordinary course of business, such as restitution between fraud victims, its inadequacy may still be felt.

A. *What Is "Value"?*

To understand more clearly the creditor/payee's affirmative defense and the problem of antecedent debt as value, we need to take two steps backwards.

(1) Bona fide purchase in all its aspects is an equitable defense. A purchaser who meets its requirements takes free of "prior equities" to which the property in question would otherwise be subject—for instance, that the purchaser's transferor had acquired it by fraud from a third party. Both the

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4. RESTATEMENT OF RESTITUTION (AM. LAW INST. 1937).

5. *Id.* at § 14.

6. *See infra* text accompanying note 48.

bona fide purchase doctrine in general, and its specific requirements in particular, are best understood by reference to one of equity's greatest (though unwritten) maxims: Equity will do what it can to right an injustice to one party, but it will stop short at the point where its remedy would do an injustice to another party. If A is induced by fraud to transfer X to B, B's title is defective. A can, therefore, retake X, so long as A can find B with *X* still in his possession. However, if B has transferred X to C before A catches up with him, the inquiry shifts: what were the circumstances in which C acquired X from B? If it would be inequitable to require C to restore X to A, A's rights in the property are cut off by the doctrine of good faith purchase. (Second prize in the contest between A and C is naturally a right of recourse against B.)

(2) C qualifies as a bona fide purchaser—and will thus be protected against A's claim—if C acquired X as an innocent purchaser for value. This means that C must have taken the property (i) as a purchaser (and not, for example, merely as a successor in interest); (ii) without notice (such being the true meaning of the expressions "innocent" and "in good faith"); and (iii) for "a valuable consideration," later shortened to "value." All three elements of this test might be explicated as ways to test the overall "balance of equities" between A and C, but the problematic one has always been "value."

The threshold problem is to distinguish the "consideration" required to make a promise enforceable from the "valuable consideration" needed to validate a purchaser's title. Confusion is heightened because the functions of the two concepts might initially appear similar. Of course, a gratuitous promisee cannot enforce a contract. In the same way (or so it might seem), a gratuitous or "donee" transferee cannot take free of prior equities. But the distinctive characteristics of "value" come into view when we see how it *differs* from consideration. In contract law, "promise for promise" is probably the most common form of consideration there is; yet in its traditional (pre-U.C.C.) version, a promise of performance constitutes value only to the extent the promise has been performed. The special status of the creditor/payee turns on a different aspect of the value question, historically the most vexed. We would not hesitate to find that a promise made to satisfy a pre-existing (or "antecedent") debt was made for consideration. (To settle my outstanding debt of $500, I promise to deliver a cow instead.[7]) Nor would consideration normally be an issue if I make you a promise to secure payment of an antecedent debt. If you hold Smith's promissory note for $500, and I guarantee payment by adding an endorsement, my guaranty is not unenforceable for lack of consideration.[8] On the score of "value," however, both transactions were open to question. If you give me a cow to settle your outstanding debt of $500, and it later transpires that you obtained the cow from its previous owner by fraud, it is not at all clear (apart from statute) that I have given value for the cow when the previous owner comes to reclaim it. If you give me a mortgage on the same cow to secure the same outstanding debt, it is almost certain that I have *not* given value.

These traditional problem areas of "value"—the unperformed promise of performance, the satisfaction of antecedent debt, the security for antecedent debt—all come into focus once we see that "consideration" and "value" are the shorthand answers to entirely different questions. When the answer is "consideration," the question is, "have the parties made a bargain?" But when the answer is "value," the question is, "has the transferee undergone a *change of position*—such that an obligation to restore the property to the claimant would be inequitable to the transferee?"[9] The case of the unperformed promise (so long as the promise is not irrevocable) seems the simplest: until I put my hand in my pocket to pay you, I can always refuse to proceed. "Satisfaction of antecedent debt" is at least doubtful—If the cow you gave me turns out to belong to someone else so that your

7. *See* RESTATEMENT (SECOND) OF CONTRACTS § 279 (AM. LAW INST. 1981) (stating promise of a substitute performance gives rise to enforceable "substituted contract").

8. *See* U.C.C. § 3-419(b) (2002) ("The obligation of an accommodation party may be enforced . . . whether or not the accommodation party receives consideration for the accommodation."). General principles of suretyship are likewise quick to find—by one means or another—the consideration necessary to support the surety's obligation. *See* RESTATEMENT (THIRD) SURETYSHIP & GUARANTY § 9 (1996) ("[T]he requirement of consideration for secondary obligations is the same as for contracts generally.").

9. The legal realist quip of the 1930s was that "the defense of purchase for value may be nothing more than an instance of change of position grown doctrinaire." Henry Cohen, *Change of Position in Quasi-Contracts*, 45 HARV. L. REV. 1333, 1342 (1932) (citing an anonymous note at 36 HARV. L REV. 858 (1923)). Other authors have published more earnest statements of the same idea. *See* Henry W. Ballantine, *Purchase for Value and Estoppel*, 6 MINN. L. REV. 87, 121 (1922) ("These are found in a kind of estoppel which generally exists, even if there is no inquiry in each particular case as to misreliance on ostensible ownership . . . ."); Stephen Langmaid, *Quasi-Contract—Change of Position by Receipt of Money in Satisfaction of a Preëxisting Obligation*, 21 CALIF. L. REV. 311, 319 (1933) ("The significant point is that the doctrine of purchaser for value, whether at law or in equity, rests upon and is merely a branch of a more general doctrine of change of position.").

antecedent debt to me is reinstated, am I not back where I started? Creditors objected that they might have forgone various opportunities of recourse, suggesting at least the potential for a change of position. Nevertheless, "security for antecedent debt" seemed even harder to justify in these terms. If you secure a pre-existing debt, not yet at maturity, by giving me a mortgage on someone else's cow—and my security turns out to be illusory—it is hard to see that I am any worse off if I find myself once again unsecured.

Traditional rules about what constitutes value would be mystifying to many lawyers today, though they are by no means ancient history. In most U.S. jurisdictions, before the enactment of the Uniform Commercial Code, a creditor who took *goods* in satisfaction of an antecedent debt was not protected as a bona fide purchaser.[10] To this day, it is unlikely that an unperformed promise or a mortgage securing an antecedent debt will make one a bona fide purchaser of real property[11] or of property transferred in

10. As late as 1948, the leading treatise on sales law still reported that:

> Many courts have taken a distinction between chattels and negotiable paper . . . [and] it has been generally held that taking chattels even in absolute payment of a pre-existing debt does not constitute the holder a purchaser for value.
>
> . . .
>
> It has also . . . most commonly been held that one who takes chattels as collateral security for an antecedent debt is not a purchaser for value.

3 SAMUEL WILLISTON, THE LAW GOVERNING SALES OF GOODS § 620, at 397–98 (rev. ed. 1948). Williston himself took the view that the more liberal definition of value should govern the purchase of property of any description. *Id.* at 399–400.

11. According to current authority: "[t]he grantee who gives a promise to pay, as distinct from an actual payment, is not considered to have given value." Moreover,

> A common problem is raised by the creditor who takes a mortgage or other interest in land as further security for a pre-existing debt. For example, a bank may make an unsecured loan and later ask the debtor to give it a mortgage as security. Unless the bank somehow changes its position detrimentally in return for the mortgage, as by granting an extension of time for repayment, agreeing to forbear bringing suit, or giving some other concession such as a reduction in interest rate, it will by the large majority of cases be deemed not to have given value under the recording acts.

WILLIAM STOEBUCK & DALE WHITMAN, LAW OF PROPERTY § 11.10, 880–81 (3d ed. 2000) (citations omitted). The authors note that the Uniform Land Transactions Act (ULTA), promulgated by the National Conference of Commissioners on Uniform State Laws in 1975 and again (after amendment) in 1977, would have displaced these traditional limits with all-inclusive definition of "value" taken from the U.C.C. UNIF. LAND TRANSACTIONS ACT § 1-201(19) (amended 1977), *later withdrawn*.

breach of trust[12]—though the lawyer who wants to argue in a non-U.C.C. context that "value" is not identical with "consideration" may have difficulty mustering modern authorities. The old controversy surrounding the definition of value tells a story that is simple enough. What began as an equitable defense, subject to an equitable test, gradually became a commercial rule in which the underlying equity was no longer discernible. The parties to recurring commercial transactions—and the judges of their disputes—wanted predictability and finality more than they wanted equity. Restitution in any context disrupts a status quo, and a preference for finality will inevitably leave less room for restitution. Defenses to restitution expand, and liabilities contract.

Defenses to restitution started with the idea of countervailing equity. Just as the gist of the action was "that the defendant, upon the circumstances of the case, is obliged by the ties of natural justice and equity to refund the money," so the defense was "every thing which shews that the plaintiff, *ex aequo & bono,* is not entitled to the whole of his demand, or to any part of it."[13] The most natural way to make the defensive equitable showing, then and now, is to point to a change of position on the part of the defendant—ideally, a change of position in response to the transaction the claimant seeks to reverse—making it impossible to right one injustice without inflicting another.

At the outset, even a hard-headed commercial judge like Lord Mansfield was fully prepared to find that a creditor/payee who could not show a detrimental change of position was not entitled to a defense. In *Buller v. Harrison*,[14] an insurance company had paid a claim in the amount of £2,100, "thinking the loss was fair." Payment was made to defendant, the London agent of the policyholders, who themselves were "resident at New York."

12. Austin W. Scott's comprehensive treatment of "value" in the context of transfers of trust property, setting forth all of what are described here as the traditional rules, appeared in the original *Restatement*. RESTATEMENT OF TRUSTS §§ 298–309 (AM. LAW INST. 1935), *reprinted in* RESTATEMENT (SECOND) OF TRUSTS §§ 298–309 (AM. LAW INST. 1957). Scott's treatise (here a commentary on his own *Restatement*) repeats the same rules, with additional explanation and numerous citations. For the most recent full-length version, *see* 4 AUSTIN W. SCOTT, LAW OF TRUSTS §§ 298–309.1, at 143–200 (Fratcher, 4th ed. 1989). In a more recent edition of the treatise the discussion of value has been rearranged and slightly abridged, without substantial change. 5 AUSTIN W. SCOTT & MARK ASCHER, SCOTT AND ASCHER ON TRUSTS §§ 29.3–29.3.12, at 2026–55 (Ascher 5th ed. 2008) (discussing "what constitutes value for purposes of enabling a transferee of trust property to hold the property free of trust").

13. Moses v. Macferlan 97 Eng. Rep. 676, 679–81; 2 Burr. 1005, 1010–12 (K.B. 1760).

14. Buller v. Harrison 98 Eng. Rep. 1243; 2 Cowp. 565 (K.B. 1777).

Discovering shortly thereafter that in fact, "it was a foul loss," the insurer sued the agent to recover the money. Agent's defense was that his principals, at the time of the payment, had been indebted to him in the amount of £3,000, and that he had credited the £2,100 insurance proceeds against this antecedent debt. Lord Mansfield rejected the defense in memorable terms:

> [S]hall a man, though innocent, gain by a mistake, or be in a better situation than if the mistake had not happened? Certainly not. In this case, there was no new credit, no acceptance of new bills, no fresh goods bought or money advanced. In short, no alteration in the situation which the defendant and his principals stood in towards each other on the 20th of April. What then is the case? The defendant has trusted Ludlow and Co. and given them credit. He trafficks to the country where they live, and has agents there who know how to get the money back. The plaintiff is a stranger to them and never heard of their names. Is it conscientious then, that the defendant should keep money which he has got by their misrepresentation, and should say, though there is no alteration in my account with my principal, this is a hit, I have got the money and I will keep it?[15]

Mansfield's equitable acid test would prove to be influential. The purpose of an equitable defense is to foreclose a liability in restitution that would leave the defendant worse off than if the transaction in question had not occurred. If the result of allowing the defendant to take free of prior equities would be to leave the defendant *better* off than if the transaction had not occurred—"this is a hit, I have got the money and I will keep it"—the function of the defense has evidently been perverted. Such is not infrequently the result, as we shall see, if antecedent debt (however worthless) counts as value between successive fraud victims.

B. *Kent v. Story*

The old question of whether the satisfaction of antecedent debt counts as "value" recurs in many cases of restitution between victims of a common fraud. This is because the affirmative defense normally allowed to the creditor/payee is what allows a more fortunate victim—one who has recovered some of the investment through prior withdrawals—to hold that money free of the restitution claims of fellow victims from whose funds such withdrawals were necessarily paid. Concededly, a victim who spends

15. *Id.* at 1245; 2 Cowp. at 568.

the funds so withdrawn (not suspecting the fraud) might be able to show a change of position that Lord Mansfield would have accepted as grounds for an equitable defense. In other cases, the fact of a prior withdrawal may simply amount to a lucky break. If satisfaction of antecedent debt *automatically* constitutes value in these cases—without asking whether the recipient has actually given up anything—the result is the repayment of one victim by a fraud on another, an outcome Mansfield would certainly have condemned. If the distinction seems unfamiliar, it is because—at least where payments are concerned—a standard commercial conception of this three-cornered relationship has long since displaced the original equitable basis of the affirmative defense.

The American history of the question starts with the landmark case of *Coddington v. Bay*,[16] in which New York's highest court affirmed a decision made in the first instance by its famous Chancellor, James Kent.[17] *Coddington* placed the law of New York in the direct line of Lord Mansfield's decision in *Buller v. Harrison*, and New York held that ground for the rest of the century—supported by courts in only a handful of states—in opposition to the rising commercial tide.

Bay, residing in Hudson, New York, owned the schooner *Express*. He engaged the firm of Randolph and Savage in New York City to act as his agents for the sale of the *Express* on credit, instructing them to take "unexceptionable paper." R&S sold the *Express* for $3,875, taking payment in the form of negotiable notes which (on a fraudulent pretext) they delayed remitting to Bay. Eight days after the sale, R&S ceased paying their creditors. They assigned various assets (including the notes received on the sale of the *Express*, belonging in equity to Bay) to another New York firm—partners named Coddington—to secure them against contingent "responsibilities." The Coddingtons were almost but not quite creditors of R&S at this point; they were accommodation endorsers of some of R&S's unmatured notes. But as these notes would fall due in the coming weeks, and as R&S were now known to be insolvent, it was understandable that the Coddingtons were eager to have security for the payments they would shortly be obliged to make on R&S's behalf. The Coddingtons sold some of Bay's notes a few days later, to purchasers having no notice of Bay's equitable interest. Bay discovered what had happened and sued the

16. Coddington v. Bay, 20 Johns. 637 (N.Y. 1822), *aff'g* Bay v. Coddington, 5 Johns. Ch. 54 (N.Y. 1821).

17. *Id.*

Coddingtons to recover the remaining notes and the proceeds of the ones they had already sold.

The defendants argued that they were entitled to the same protection allowed innocent purchasers of money and bank notes. Chancellor Kent's opinion began by recalling the most famous of the authorities on which that defense was based:

> In *Miller v. Race,* (1 *Burr*. 452.) a bank note was stolen and came into the hands of the plaintiff, and he was held entitled to it. But the Court of *K. B.* considered bank notes as cash, which passed as money in the way of business; and the holder, in that case, came by the note, for a full and valuable consideration, by giving money in exchange for it, in the usual course of his business, and without notice of the robbery, and on those considerations he was entitled to the amount of the note.[18]

By contrast, the Coddingtons were not holders of Bay's misappropriated notes "for a valuable consideration within the meaning or within the policy of the law."[19] A valuable consideration for this purpose—that is, a consideration sufficiently weighty to cut off prior equities—involved the sort of change of position that Lord Mansfield had required in *Buller v. Harrison*, and that defendants here could not show:

> In short, I have not been able to discover a case in which the holder of negotiable paper, fraudulently transferred to him, was deemed to have as good a title, in law or equity, as the true owner, unless he received it not only without notice, but in the course of business, and for a fair and valuable consideration given or allowed on his part, on the strength of that identical paper. It is the credit given to the paper, and the consideration *bona fide* paid on receiving it, that entitles the holder, on grounds of commercial policy, to such extraordinary protection, even in cases of the most palpable fraud. It is an

18. Bay v. Coddington, 5 Johns. Ch. 54, 57 (N.Y. 1821). In the case cited by Chancellor Kent, Miller v. Race, 1 Burr. 452, 97 Eng. Rep. 398 (K.B. 1758), a highwayman had robbed the mail, taking a bank note for £2,110. Like paper money today, the note was payable to bearer. The day after the robbery, someone having "the appearance of a gentleman" used the stolen bank note to pay his hotel bill. Observing that the innkeeper took the instrument without notice, for a valuable consideration, and in the ordinary course of business, Lord Mansfield held that he was a protected purchaser of the note and entitled to enforce it.

19. *Id.*

> exception to the general rule of law, and ought not to be carried beyond the necessity that created it.[20]

Defendants appealed to New York's Court for the Correction of Errors, which affirmed Chancellor Kent by a vote of 22–7.[21] The published opinions emphatically approved and largely repeated Kent's authorities and reasoning, while adding two arguments that would become hallmarks of New York law on the subject—henceforth, "the rule of *Coddington v. Bay*." The first was to refute the contention that a creditor/payee's change of position might be inferred or presumed if one looked hard enough; in particular, that a payee who had not actually done anything on receipt of the claimant's funds or paper might nevertheless have been "lulled into inactivity."[22] In New York, a change of position would not be inferred, at least when the facts of the case made it so unlikely:

> It was suggested, that they might have lost the benefit of some other security, had they not taken these notes; but of this there is no proof or probability. It is not shown, or pretended, that *Randolph and Savage* had any other security to give; and it cannot be presumed, that they would have committed such a flagrant breach of faith, if they had any other available funds in their hands.[23]

The second contribution made by the Court for the Correction of Errors was to underscore Lord Mansfield's equitable bottom line in *Buller*. Would a liability in restitution, under the circumstances of the case, leave the creditor/payee worse off than if the challenged transaction had never occurred?

> The true test I take to be, that when the holder is left in as good a condition, after a retransfer, as he would have been had no transfer taken place there, the title of the owner shall prevail. This allows the rule, so far as it is dictated by commercial policy, to have its full effect, while it protects the owner of

20. *Id.* at 58–59.

21. *Coddington*, 20 Johns. at 658. Under the New York Constitution of 1777, the members of the state's highest court included the President and members of the Senate, as well the Chancellor and the judges of the Supreme Court. N.Y. CONST. of 1777 art. XXXII.

22. Counsel for the defendant in *Buller v. Harrison* tried to argue that their client considered the money as his property at the time it was paid "and for eleven days after," and that "under this idea he was lulled into security, and did not take any means during that interval, to get the money from New York." Buller v. Harrison 98 Eng. Rep. 1243, 1245; 2 Cowp. 565, 567 (K.B. 1777). Lord Mansfield ignored this suggestion.

23. *Coddington*, 20 Johns. at 650.

> negotiable paper, necessarily intrusted, in the course of business, to the care of agents, from an injury revolting to every principle of moral equity.[24]

Logically, such a but-for comparison merely paraphrases the equitable test of change of position, but it does so in a way that makes it intuitive and unmistakable. The equitable objection, so stated, is one that a non-relying creditor/payee can never meet, and the mercantile rule that now developed in contradistinction to the equitable rule did not attempt to meet it. The rationale of the creditor/payee's defense, in its mercantile form, was not equitable at all.

The landmark on the opposite side of the question emerged twenty years later in *Swift v. Tyson*,[25] decided by the United States Supreme Court in an opinion by Justice Joseph Story. *Swift v. Tyson* remains a famous case, though it is known today for an altogether different point: namely, its clear statement of the rule that in deciding questions of general commercial law, the U.S. federal courts were not bound by the judge-made law of the courts of the several states, but were free to follow their own view of the authorities and of the relevant principles of law and equity. This collateral issue of federal jurisdiction required some attention before the Court could reach the commercial question at the heart of the lawsuit. The case originated in New York, and one of the parties was arguing that it should be decided in accordance with New York law—the rule of *Coddington v. Bay*—even though the suit was in federal court. Justice Story was determined to announce a contrary rule about the "valuable consideration" needed to validate a transfer of commercial paper. As a necessary prelude, he ruled—more emphatically than the Supreme Court had previously had occasion to do—that the federal courts were not bound to follow New York commercial law in deciding a New York case.[26]

24. *Id.* at 657 (Vielie, Sen., concurring). All three opinions emphasized this point. *See id.* at 648 (Woodward, J., concurring) ("If the notes became effectual in their hands, then so much was gained; if not, they remained in *statu quo.")*; *id.* at 650 (Spencer, C.J., concurring) ("If they have to account to the respondent for these notes, their situation is exactly as it would have been had the notes not been transferred to them.").

25. Swift v. Tyson, 41 U.S. (16 Pet.) 1 (1842).

26. The Judiciary Act of 1789 provided "that the laws of the several states . . . shall be regarded as rules of decision[,] in trials at common law[,] in the courts of the United States[,] in cases where they apply." The question was whether "the laws of the several states" in that context referred only to state constitutions and statutes, or whether the phrase included the rules of judge-made law that might be followed in a particular state—for example, the extent of the "valuable consideration" needed to qualify as a protected holder of commercial paper. According to Story, "[i]t never has been supposed by us, that the section did apply, or was designed to apply, to questions of a more general nature . . . and

Norton, a swindler in Maine, purported to sell land to Tyson, a victim in New York, misrepresenting both the attributes of the land and the state of his title. Tyson paid Norton for the land by accepting a draft at six months, drawn by Norton on Tyson and payable to Norton. (The effect was the same as if Tyson had given Norton a negotiable promissory note due in six months.) Swift, one of Norton's creditors, held an overdue note on which Norton was liable. To redeem the defaulted note, Norton gave Swift several items of negotiable paper, including the draft that had been accepted by Tyson. Swift had no notice of any defect in the transaction between Norton and Tyson. On discovery of the facts, Tyson repudiated the fraudulent land deal with Norton and refused to honor the draft. Swift sued Tyson, claiming that as purchaser of the draft for a valuable consideration, he held it free of prior equities.

What made the case interesting was the assumption on all sides—not actually tested in this litigation—that Swift would not have been able to enforce the draft against Tyson in New York, where Tyson resided, because Swift had not given "valuable consideration" within the rule of *Coddington v. Bay*. Justice Story stated a broad rule to the contrary: that a transfer of a negotiable instrument, either as payment of an antecedent debt or merely as security for payment, is a transfer "in the usual course of trade and business" and for valuable consideration—entitling the transferee to enforce the instrument free of prior equities.[27] The part about a transfer for security was pure dictum, since it was unnecessary to the decision, but it was actually the key feature of the commercial rule that Story was determined to adopt for the federal courts.

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especially to questions of general commercial law . . . ." *Id.* at 18–19. Story was probably correct, both about what had previously been supposed and about what had been intended in 1789. When 19th-century lawyers spoke of "the rule in *Swift v. Tyson*," they were talking about antecedent debt, not "rules of decision." But unanticipated consequences of the original reading of the Judiciary Act eventually became intolerable. Once there had developed, at a few critical points, a significant divergence between "federal common law" and the common law of a particular state, a plaintiff with access to both state and federal courts might select the law governing his case—and determine its outcome—by choosing the court in which to sue. The Supreme Court eventually responded to this problem of "forum shopping" by holding that the Judiciary Act of 1789—assuming that it meant what Story said it meant—had been in that respect unconstitutional. *See generally* Erie R. Co. v. Tompkins, 304 U.S. 64 (1938) (describing "forum shopping" as one of the twin evils). The intended result is that state and federal courts in a given jurisdiction decide non-federal questions by applying the same governing law—and to a modern lawyer, "the rule in *Swift v. Tyson*" means only "the rule that was overruled in *Erie v. Tompkins*."

27. *Swift*, 41 U.S. at 19.

The reasons given in *Swift v. Tyson* are interesting for what they leave out. Unlike *Buller* and *Coddington*, they do not refer whatsoever to the parties' competing equities. After explaining that the federal courts would not take their law from the courts of New York, Story reached the heart of the matter:

> It becomes necessary for us, therefore, upon the present occasion, to express our own opinion of the true result of the commercial law upon the question now before us. And we have no hesitation in saying, that a pre-existing debt does constitute a valuable consideration, in the sense of the general rule already stated, as applicable to negotiable instruments . . . . And why, upon principle, should not a pre-existing debt be deemed such a valuable consideration?[28]

The usual answer to Story's rhetorical question—as he knew perfectly well—was that a creditor who accepts payment in property not belonging to his debtor has not necessarily undergone any change of position. If payment is reversed, the debt is revived, and the creditor may be left where he started. Of course, the inconvenience to the repaid creditor might in fact be significant. The question of change of position would be burdensome to determine in some individual cases, and there are other good reasons not to adopt such a rule.

But what of the creditor who acquires some third party's property merely as security for debts already contracted, and who can show (in Lord Mansfield's words) "no new credit, no acceptance of new bills, no fresh goods bought or money advanced"?[29] If the lien is avoided, there will often be no prejudice to the creditor; while if the lien is enforced, the creditor is repaid in someone else's money. There are reasons to recognize the validity of the pre-existing creditor's lien, but change of position and countervailing equity are plainly not among them. Nor did Justice Story assert that they were:

> It is for the benefit and convenience of the commercial world, to give as wide an extent as practicable to the credit and circulation of negotiable paper, that it may pass not only as security for new purchases and advances, made upon the transfer thereof, but also in payment of, and as security for, pre-existing debts. The creditor is thereby enabled to realize or to secure his debt, and

28. *Id.* at 19–20.
29. *Buller*, 98 Eng. Rep. at 1245; 2 Cowp. at 569.

> thus may safely give a prolonged credit, or forbear from taking any legal steps to enforce his rights. The debtor also has the advantage of making his negotiable securities of equivalent value to cash. But establish the opposite conclusion, that negotiable paper cannot be applied in payment of, or as security for, pre-existing debts, without letting in all the equities between the original and antecedent parties, and the value and circulation of such securities must be essentially diminished . . . .
>
> What, indeed, upon such a doctrine, would become of that large class of cases, where new notes are given by the same or by other parties, by way of renewal or security to banks, in lieu of old securities discounted by them, which have arrived at maturity? Probably, more than one-half of all bank transactions in our country, as well as those of other countries, are of this nature. The doctrine would strike a fatal blow at all discounts of negotiable securities for pre-existing debts.[30]

The emphasis, somewhat unexpectedly, is on the less obvious proposition: that taking an instrument, not in payment, but merely as *security* for a pre-existing debt, is a purchase "for valuable consideration." Recall that this part of the rule was unnecessary to a decision of the case, since Swift had taken Tyson's paper in payment of Norton's debt, not as security. Consider, moreover, how awkward it is to explain that a creditor "gives" anything—let alone "valuable consideration"—if he merely takes collateral security for a pre-existing debt. These incongruities offer a hint that the central concern of *Swift v. Tyson* is not what appears at first glance.

The facts made it a case of owner v. creditor. On such facts, the rule of *Swift v. Tyson* is that the creditor takes free of the owner's rights: he is "unaffected with the equities between the antecedent parties."[31] Justice Story's real concern, however, is not with the restitution case of owner v. creditor, but with the strictly commercial case of creditor v. creditor. The critical function of the commercial rule, in other words, was not to cut off the rights of "antecedent parties" such as defrauded owners, but to confirm the validity of a transfer between "immediate parties"—typically a bank and its customer. The transactions that Story is describing boil down to this: Borrower delivers negotiable notes to his banker to serve as collateral security for outstanding loans or acceptances and future advances. If Borrower's loans are of longer maturity than his collateral, Borrower will eventually have to furnish substitute collateral—probably in

30. *Swift*, 41 U.S. at 20.
31. *Id.* at 19.

the form of more notes. Does the banker acquire a valid security interest in the substitute collateral? Once in a great while, the person challenging the banker's lien might be a defrauded prior owner, as in *Coddington v. Bay*. More often, the problem would be a challenge by Borrower's other creditors, upon Borrower's insolvency, to the validity (or priority) of the bank's lien. A pledge of collateral between Borrower and bank was not valid until the bank gave "value."[32] The system of credit that Story describes could survive the occasional case like *Coddington v. Bay*—the New York banks do not appear to have suffered appreciably from the New York rule. The "fatal blow at all discounts of negotiable securities for pre-existing debts" would have been to tolerate any doubt about the validity of the security arrangements on which the bank's priority depended.

New York courts indignantly rejected the result in *Swift v. Tyson*, though they eventually accepted Story's point about the market for commercial paper. Consideration that might be "good" or "sufficient" to validate a transfer between the immediate parties—a debtor's payment on account, or his pledge to secure past or future advances—was not the consideration of "actual value" required "to protect the holder of a negotiable security which has been passed to him in fraud of the rights of others."[33] New York thus distinguished the commercial case of creditor v. creditor, where the issue was normally priority, from the restitution case of owner v. creditor, where the issue was prior equities.[34] In the decades of controversy that followed, New York won the adherence of a number of state courts, but a majority preferred Story's simpler, unitary rule.[35]

32. *See* 1 Gilmore, Security Interests in Personal Property § 1.6 (1965). In the same way, the threshold condition for the enforceability of an Article 9 security interest—the requirement that "value has been given," U.C.C. § 9-203(b)(1)—makes it essential that "value" be given when rights are acquired "as security for . . . a preexisting claim," U.C.C. § 1-204(2).

33. Stalker v. McDonald, 6 Hill 93, 99 (N.Y. 1843).

34. To cut off prior equities, a defendant had to show "something more than a good consideration, a consideration which would be sufficient as between the parties to the transaction . . . . [Rather,] the consideration must be valuable and actually paid, and . . . the defendant must have parted with value upon the faith of the purchase." Weaver v. Barden*,* 49 N.Y. 286, 291 (1872).

35. Reviewing the decisions on either side of the question, the Illinois court noted that "[t]he fact that the various courts of this country are so arrayed against each other upon this question is the best possible evidence of its intrinsic difficulty." Manning v. McClure, 36 Ill. 490, 493 (1865). But Illinois sided with *Swift v. Tyson*, finding that the taking of negotiable paper as security for a pre-existing debt would normally imply a forbearance on the part of the creditor.

> We have only to add, that the line of decisions which we follow contributes to that stability in negotiable paper which is so important a consideration in a mercantile community. To accomplish this has been the constant tendency of judicial decisions from the time of

Statutes eventually put an end to the discussion, so far as negotiable instruments were concerned. According to the English Bills of Exchange Act (1882):

> Valuable consideration for a bill may be constituted by,—
>
> (a) Any consideration sufficient to support a simple contract;
>
> (b) An antecedent debt or liability. Such a debt or liability is deemed valuable consideration whether the bill is payable on demand or at a future time.[36]

The Act encouraged the use of the word "value" as a relatively colorless substitute for "valuable consideration"[37]—facilitating the understanding that the expression was really a term of art, and that a "valuable consideration" in this context need not be "valuable" in any literal sense. In the U.S. paraphrase that followed soon after, the Bills of Exchange Act became the Negotiable Instruments Law—promulgated in 1896 as the first of the "uniform laws" proposed (by a newly-formed commission) for adoption by the legislatures of the several states:

> Value is any consideration sufficient to support a simple contract. An antecedent or pre-existing debt constitutes value, and is deemed such whether the instrument is payable on demand or at a future time.[38]

New York adopted the NIL in 1897, but ten years later the New York Court of Appeals was still enforcing the rule of *Coddington v. Bay*.[39] As the Court later explained, "the New York rule was so well established that the inertia

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> Chief Justice Holt to the present day. The value of this stability to commerce is acknowledged by all courts, and by all writers upon mercantile law. It is easy to see how much it strengthens credit and facilitates the multitudinous transactions of a commercial people.

Id. at 498. According to a well-known modern appraisal, "the much heralded quest for legal uniformity that *Swift v. Tyson* is supposed to have represented can also be seen more concretely as an attempt to impose a procommercial national legal order on unwilling state courts." MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1780–1860, at 250 (1977). But unwilling state courts were by this point few and far between.

36. Bills of Exchange Act 1882, 45 & 46 Vict. ch. 61, § 27(1).

37. *See id.* 61, § 2 ("'Value' means valuable consideration").

38. NEGOTIABLE INSTRUMENTS LAW § 32 (1896) *reproduced in* UNIF. NEGOTIABLE INSTRUMENTS ACT § 25 U.L.A. app. I (1943).

39. Bank of America v. Waydell, 187 N.Y. 115, 120 (1907).

of *Coddington v. Bay* carried it along for some distance before the external force of the Negotiable Instruments Law acted upon it."[40]

III. VICTIM V. VICTIM RESTITUTION

Modern practice makes it unlikely that one Ponzi victim would assert claims directly against another, though a suit for restitution by "net losers" against "net winners" would certainly be possible as a matter of doctrine.[41] Instead, the victims' claims *inter se* are adjudicated indirectly—by the receivers who are typically charged by federal courts to marshal assets in the wake of the scheme and to recommend an equitable distribution between multiple victims. A standard "net loss" approach incorporates two legal doctrines that potentially increase the share of some victims and the expense of others, as a result of circumstances that may be entirely fortuitous. The rule that satisfaction of antecedent debt constitutes "value," when applied "no questions asked"—thereby making the debt of an insolvent swindler as "valuable" for this purpose as an obligation of the U.S. Treasury—means that victims who have previously withdrawn some or all of their investments will not have to share such payouts with victims who withdrew nothing. The rule that permits an owner to reclaim stolen property—so long as it remains identifiable—means that net losses may well be determined by the accident of which victim's assets happen to remain on hand. If a swindler gets dollars from me and Swiss francs from you, then spends the dollars and keeps the francs in his desk drawer, you recover your currency (and reduce or eliminate your net loss), while my loss is 100%.

There can be no objection to these results if the net loss is the proper baseline for an equitable distribution. A fraud victim who has persuaded a swindler to repay some of the money, or who is lucky enough to find some of his property intact, naturally suffers a smaller loss than he would have otherwise—like a burglary victim whose jewelry is recovered when the thief is arrested. Recent decisions in the post-Ponzi context reject these consequences as inequitable because they reject the net loss baseline. The courts do not put it in those terms. What they say is that the incidence of losses between victims similarly situated should not be allowed to depend on mere fortuity: the chance of identification; the sequence of events; or the accident of whose money a swindler happens to spend first. But if the

40. Kelso & Co. v. Ellis, 224 N.Y. 528, 536–37 (1918).

41. For an indication of how the claim might be framed, *see generally* Andrew Kull, *Common-Law Restitution and the Madoff Liquidation*, 92 B.U. L. REV. 939 (2012).

victims are indeed "similarly situated," it is because their entitlements are properly fixed at the outset—when they first part with their money—not in the aftermath of the fraud, when losses are "net."

These basic rules about antecedent debt and retaking one's own property are not subject to serious challenge, so long as transactions take place in an ordinary commercial context. By contrast, the respective entitlements *inter se* of victims of a common fraud have at times received different treatment. There are venerable decisions that refuse to apply the rule of "antecedent debt" to the discharge of an obligation that was spurious from the outset. The more fundamental rule—that a dispossessed owner can retake his identifiable property—has plainly been harder to overcome, but (as we shall see) recent decisions in post-Ponzi cases have denied even this.

The first problem, concerning antecedent debt, is easier to see in its classic, two-party setting than in the multi-victim Ponzi version. Swindler obtains money from Victim 1, giving a forged note secured by a lien on property he does not own. When Victim 1 demands repayment, Swindler repeats his successful fraud with Victim 2—borrowing again on the same pretended security, and directing Victim 2 to repay Victim 1 to discharge the imaginary prior lien. If these facts can be established, V1 is prima facie liable to V2 in restitution. The question then becomes whether V1's innocent acceptance of V2's money in satisfaction of V1's claim against Swindler constitutes a purchase for value, giving V1 a defense to V2's claim.

The same question arises in a post-Ponzi setting when (as is often the case) some earlier, more fortunate victims have previously withdrawn funds from the scheme, and where any funds they withdrew were necessarily obtained from subsequent victims of the same fraud. The recipients of these payouts will claim the protection normally afforded to creditor/payees—explaining that they took the funds, without notice of the fraud, in reduction of Swindler's preexisting obligation to them. Recognition of this affirmative defense yields the conventional rule governing Ponzi withdrawals: recipients can keep them free of liability in restitution, but only to the amount of their original investments.[42] The effect of the rule is that entitlements as between victims—assuming there remains something to allocate—are proportional to net losses, defined as aggregate investments minus aggregate withdrawals.

42. *See, e.g.*, Donnell v. Kowell, 533 F.3d 762, 770 (9th Cir. 2008) (defining the net-loss rule governing Ponzi withdrawals).

Proportional allocation based on initial investments would instead require that all previous withdrawals be made subject to restitution, enabling a ratable distribution overall. Courts have shied away from this conclusion. A rule requiring restitution by the innocent recipients of Ponzi payouts is unattractive for several reasons, including the expense of collection and the likelihood that many of the recipients will have changed position by spending the money. Recent decisions have nevertheless taken a notable half-step in this direction, approving new methods of distribution whose tendency is to equalize losses in proportion to investments—but only so far as this can be done without imposing on any victim an affirmative liability to repay funds previously withdrawn.[43]

The second branch of the net loss dilemma, in which Swindler spends my dollars but holds on to your francs, presents a more fundamental difficulty. A rule of share and share alike, or ownership in proportion to original contributions, is not only familiar but inevitable in any case where multiple owners' property has been "confused" or "commingled."[44] So if the dishonest warehouseman has taken my wheat and your wheat, stored them in the same elevator, and converted some of the mixture, you and I own the residue in proportion to what we had originally stored. The result is the same if your money and my money are commingled in Swindler's bank account in a way that makes the funds untraceable. What makes some recent Ponzi cases controversial is that receivers want to apply a rule of share and share alike to reassign property that remains readily identifiable.[45]

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43. The new approach substitutes what is called the "rising-tide method" of distribution for the traditional "net loss method." *See infra* text accompanying note 62.

44. *See, e.g.*, Daniel Friedmann, *Restitution for Wrongs: The Measure of Recovery*, 79 TEX. L. REV. 1879, 1905 (2001) ("[W]hen goods of similar nature belonging to different parties are intermixed in such a way as to make their separation impossible," the normal solution is "co-ownership in proportion to the relative contribution of the properties involved.").

45. In the earliest of this line of decisions, *SEC v. Elliott*, victims "loaned" their securities to Swindler, delivering registered certificates with stock powers attached. Most of the securities entrusted in this way had been sold and the proceeds lost; some had been left untouched, still registered in the names of the victims who had "loaned" them. The receiver (with the approval of the district court) refused to restore these securities to their previous owners. Doing so "would create inequitable results, in that certain investors would recoup 100% of their investment while others would receive substantially less." SEC v. Elliott, 953 F.2d 1560, 1569 (11th Cir. 1992). The Eleventh Circuit agreed: "Legally, these investors occupy the same position as the other investors whose securities were sold. All investors were defrauded. All investors were cleverly persuaded to part with their securities." *Id.* In *United States v. Durham*, the funds of 13 victims had been commingled in Swindler's bank account, which had a closing balance of over $83,000 when the scheme was halted. United States v. Durham, 86 F.3d 70 (5th Cir. 1996). One of the last victims was able to identify $70,000 of this balance as the product of its own contribution, based on "uncontroverted evidence" that the relevant deposit was

A judicial refusal to restore *identifiable* property to its owners is impossible to explain in terms of existing rules, and the courts that have refused have not tried to explain—other than to say that the net loss result does not seem to be fair. It might nevertheless be possible to discern an evolving doctrine in these cases that the courts have not expressed for themselves. The proposal to be made is that these outcomes are reached by what might be called "commingling fictions"—a radical departure from ordinary property law, but no more radical (perhaps) than the "tracing fictions" that were the creation of 19th-century equity, and not so different in purpose.

A. *Creditor or Fellow Victim?*

The first systematic account of the modern law of restitution, published by the American Law Institute in 1937, treated the mercantile rule for creditor/payees as one of its most basic propositions. Chapter 2 on "Mistake, Including Fraud" included among its "Definitions and General Rules" a standard version of bona fide purchase:

> § 13. BONA FIDE PURCHASER.
>
> A person who has entered into a transaction with another under such circumstances that, because of a mistake, he would be entitled to restitution from the other,
>
> (a) is not entitled to restitution from a third person who has received title to or a legal interest in the subject matter either from the other or from the transferor at the direction of the other, and has given value therefor without notice of the circumstances[.][46]

This was immediately followed by a partial definition of the term "value"—mostly the part about antecedent debt:

> § 14. DISCHARGE FOR VALUE.
>
> (1) A creditor of another or one having a lien on another's property who has received from a third person any benefit in discharge of the debt or lien,

made subsequent to the final withdrawal. *Id* at 72. Finding that this claimant's ability to trace its funds was "the result of the merely fortuitous fact that the defrauders spent the money of the other victims first," the lower court "elected in the interest of equity to distribute the $83,000 pro rata." *Id.* The Fifth Circuit announced that it would not "chain the hands of the court in Equity to do what is right under the circumstances." *Id.* at 73. For additional decisions in this vein, *see* Kull, *supra* note 1, at 298–306 (2014).

46. RESTATEMENT OF RESTITUTION § 13 (AM. LAW INST. 1937).

> is under no duty to make restitution therefor, although the discharge was given by mistake of the transferor as to his interests or duties, if the transferee made no misrepresentation and did not have notice of the transferor's mistake.[47]

In their published notes on these sections, the ALI's Reporters—Warren Seavey and Austin Scott of the Harvard Law School—dismissed the naive idea that the rules of purchase for value reflected any concern with equitable outcomes. A purchaser from a thief obtained no protection, while the same purchase from an "embezzling trustee" might yield good title:

> In neither case is there a moral issue involved. The question is one of legal mechanics, or the operation of rules which determine who, as between equally innocent persons, is entitled to the subject matter . . . .
>
> It becomes clear, therefore, that as a new matter and from the standpoint of justice the result reached in any particular case might equally well be opposite to the result now reached under the rules. In other words, the rules as to bona fide purchase are not, as are the rules normally applicable to questions involving restitution, based upon the balance of justice between the parties, but merely upon technicalities.[48]

The Reporters seem to be saying that in an important subset of cases, lying very close to the core of the subject, the law of restitution is unconcerned with equitable outcomes. This was an overstatement, if only because a purchaser for valuable consideration normally has changed position in some significant way. But their idea might be restated in less provocative terms. Without question, a rule that treats creditors/payees as purchasers for value will yield results that are inequitable in particular cases. (The most objectionable outcomes are probably those whereby a loss is fortuitously shifted from the party who would appropriately bear it to a party whose relation to the loss-making transaction is that of an innocent bystander.[49]) Moreover, it is true that the rules of purchase for value—to

47. *Id.* § 14. The wording is awkward, since it is the transferee who gives the discharge (and the value), but the meaning is apparent.

48. W.A. Seavey & A.W. Scott, *Notes on Certain Important Sections of Restatement of Restitution* 7–8 (1937).

49. For example, as the result of a leading modern decision allowing the defense:

> Apart from the administrative expense of straightening things out—a cost that is negligible if the matter is not litigated—Security Pacific's payment mistake has not in fact caused any loss to the parties. The only real loss anywhere on the horizon—and the only reason the parties are in court—is the loss of $2 million caused by Spedley's default. The only significant consequence of

the extent they diverge from change of position—appear essentially amoral on this point, and finally, it is also true that courts will frequently tolerate inequitable outcomes for the sake of mercantile objectives that they consider more important than "the balance of justice between the parties."

Conceding all this, the cases in which claimant and defendant are successive victims of the same fraud still do not fit neatly with the others. It is not that these victim v. victim cases all come out the other way. But when this element is added to the facts, otherwise uniform authority is suddenly divided, confidence wavers, and judicial reasoning is visibly perplexed.

To explain the scope and meaning of "discharge for value," Seavey and Scott first offered five garden-variety illustrations of owner v. creditor claims—cases in which the availability of the creditor/payee's defense is undisputed. They set the tone with this uncontroversial example:

> 1. A, believing that he is devisee of B, mortgages his share in B's estate to C who, in order to sell the subject matter, pays D who has a prior mortgage thereon. In fact A is not B's devisee and has no share in B's estate. C is not entitled to restitution from D.[50]

After four more illustrations, much like this one, the atmosphere changed abruptly:

> 6. A steals an automobile and mortgages it to B who lends him $500 thereon. A then borrows $700 from C, telling C of B's mortgage. In accordance with his agreement with A, C pays B $500 to discharge B's mortgage and gives A $200, taking a mortgage for $700. The owner of the car reclaims it. C is not entitled to restitution from B.
>
> 7. Purporting to be the owner of Blackacre A borrows $5,000 from B, forging a note and mortgage in the name of the record owner of Blackacre.

> Security Pacific's mistake is that this loss on the Spedley loan has been fortuitously shifted from Banque Worms (which voluntarily assumed the associated credit risk and was paid for doing so) to Security Pacific (which had nothing to do with the loan transaction from which the loss resulted). The result in *Banque Worms* cannot be justified by reference to superior risk bearing, because the risk in question does not correlate to the loss being assigned.

Andrew Kull, *Defenses to Restitution: The Bona Fide Creditor*, 81 B.U. L. REV. 919, 922 (2001) (discussing *Banque Worms v. BankAmerica Int'l*, 570 N.E.2d 189 (N.Y. 1991)).

50. RESTATEMENT OF RESTITUTION § 14, Ill. 1 (AM. LAW INST. 1937). The illustration is based on a famous English restitution case, *Aiken v. Short*, 156 Eng. Rep. 1180, 1 H. & N. 210 (Exch. 1856).

> A then borrows $10,000 on a similarly forged mortgage of Blackacre from C who pays B $5,000 to discharge B's forged mortgage and to surrender the forged note and pays A the remaining $5,000. C is not entitled to restitution from B.[51]

By juxtaposing the owner v. creditor and the successive-fraud illustrations without a word of transition, the Reporters were implying that the cases were fundamentally the same. Their notes show that they knew better:

> In Illustrations 6 and 7 . . . the difficulty is that the payee never had a claim which was of substantial value . . . . Because of this, Mr. Patterson and Mr. Thurston, of the Advisers, believe that the payee had, in substance, lost his money when he originally lent the money to the thief or forger . . . . [Yet] the results in Illustrations 6 and 7 are consistent with the reasons for the doctrine of bona fide purchaser, since the payee acquired title to the money and surrendered something of technical value. In both of these cases the forger has defrauded both parties; the fact that the payee would have suffered had the technical rules as to bona fide purchaser not applied, is immaterial since this is frequently true in such cases . . . . The cases clearly support the results of Illustrations 1–5. *Upon Illustrations 6 and 7 the cases in point are neither numerous nor unanimous.*[52]

In fact, the victim v. victim cases are surprisingly numerous, and their very marked division of authority would have allowed the Reporters, within the ordinary usages of the American Law Institute, to state the opposite outcomes for Illustrations 6 and 7.

To distinguish the successive fraud cases from the run of the mill, it would have been necessary to acknowledge that—at least as between fraud victims—the surrender of merely "technical value," such as an antecedent debt that was manifestly worthless, could not constitute the "valuable consideration" that the doctrine of bona fide purchase originally purported to require. Reasons to resist such a distinction are not hard to reconstruct. To suggest that "value" sometimes has to be really valuable would seriously complicate the definition. It would imply the existence of different categories of cases—more or less mercantile, more or less concerned with "the balance of justice"—whose differentiation would inevitably be a matter of difficulty. More generally, it would surrender some of the ground that

51. *Id.* at § 14, Ill. 6–7.

52. Seavey & A.W. Scott, *supra* note 48, at 125 (emphasis added).

had been steadily gained for the mercantile approach over the century following since *Swift v. Tyson*, by acknowledging—contrary to the Reporters' professed convictions—that the rules of purchase for value were sometimes concerned with equity after all.

The Reporters' tactical decision made the law simpler to restate, but it made their Restatement of this point simpler than the reality. "Discharge for value," followed too uncritically by the "bona fide payee" of *Restatement Third*, describes the result for the vast majority of ordinary-course commercial transactions, but the judicial response to the victim v. victim scenario is more complex. Unable to escape the inherited formulation of the problem, the decisions for and against restitution pursue an old debate about the status of antecedent debt as "value," while the most telling objection to restitution in victim v. victim cases is rarely acknowledged. The real problem is that—when the parties have been victims of the same fraud—granting restitution does not obviously do any more for the balance of justice between the parties than denying it.

The facts of the classic successive-fraud cases were more entertaining than their schematic paraphrase in the *Restatement's* Illustrations 6 and 7, and the authorities were divided in a way the official text did not acknowledge, but the arguments on either side were mostly predictable. Judges who favored restitution saw a mistaken payment by V2 to V1, with no change of position by V1 and no "value" given in exchange:

> We are disposed to agree that an irrevocable change of position by defendant, so that a recovery will result in a loss to him, that is, put him in a worse position than he would have occupied had the money never been paid him, is a good defense to a recovery . . . . [But in] the case at bar we are unable to see that defendant, by receiving payment of his mortgage from plaintiff, and giving up the evidences of the supposed debt . . . lost anything of value. The precise claim in this regard is that, had the payment not been made, defendant, when the mortgage became due, would have discovered that the mortgage was a forgery, and would have received payment from O'Donnell, who had not yet absconded, but was still doing business in Duluth. This claim is too uncertain and speculative. The evidence as to the dealings of O'Donnell warrant no inference that he would have paid the mortgage, but, on the contrary, convince us that he would either have forged a new mortgage in renewal of the old; or, if he feared discovery of his crimes, would have left the country, as he did do later. He was not in the business of paying his debts, but of obtaining money through forgery and fraud, and it is not shown that he could have been forced to pay. We conclude that the only reasonable

> inference is that, had plaintiff not paid defendant, he would be to-day the holder of a forged note and mortgage, but of nothing else in the way of satisfaction for the money O'Donnell procured of him through fraud.[53]

Judges who denied the restitution claim responded that the defendant had suffered at least a theoretical change of position through loss of recourse, even if the debtor was finishing his career in the penitentiary. A defendant who surrendered a forged note and mortgage "has been damnified to some extent,—how much cannot be told,—if she has to lose the money paid to her."[54] There had been at least "technical value," in other words, so long as the law refused to permit any examination of what an antecedent debt was actually worth. The underlying reason to deny restitution between victims, on this approach, was to avoid unsettling the protection of creditor/payees in the standard commercial setting:

> She received [payment] in good faith, in satisfaction of a just and equitable claim, and when it was due, on honor and in conscience. And the authorities are uniform that where the money is received in good faith, and in the ordinary course of business, and for a valuable consideration, it cannot be recovered back because the money was fraudulently obtained of some other person by the payor. To hold otherwise would be to put every man who receives money

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53. Grand Lodge, AOUW of Minnesota v. Towne, 161 N.W. 403, 407 (Minn. 1917). Compare the dissenting opinion in *Walker v. Conant*:

> Mrs. Conant, by releasing her mortgage, did not release her debt against Van Riper. Her claim still remains as good as it ever was against him. Mr. Walker never received anything from her, or any one else, for the money he let her have. The mortgage she discharged was the only thing she parted with for it, and that was worthless and void. Under such circumstances, to permit Mrs. Conant to withhold the money she received from Mr. Walker would not only be inequitable and unjust, but would be allowing her to reap the fruits of the crime committed by young Van Riper . . . . It is said by my Brother MORSE, in regard to Mrs. Conant's giving up her note and mortgage: "Her situation is changed, and without her fault, beyond all possible return or restoration." If by this it is meant she has given up for destruction a forged note and mortgage which she received for a loan of money made, it is true; but if by it is meant that her legal or equitable rights are changed, in the event she is obliged to return the money she received of Mr. Walker, I confess my inability to discover such change.

Walker v. Conant, 37 N.W. 292, 296 (Mich. 1888) (Sherwood, C.J., dissenting). The same Morse and Sherwood, C.J., had been the authors one year earlier of the competing opinions in *Sherwood v. Walker*, the most famous example of mutual mistake in American contract law. Sherwood v. Walker, 33 N.W. 919 (Mich. 1887). The case involved the sale of a purebred Aberdeen-Angus cow, Rose 2d of Aberlone, believed at the time of sale (by the seller at least) to be infertile but discovered shortly thereafter to be with calf.

54. *Walker*, 37 N.W. at 294.

> in the due course of his business upon inquiry, at his peril, as to the manner in which such money was procured by the payor.[55]

The implicit proposition here—that the goal of assuring the finality of payments or "security of receipt" supersedes our usual interest in equitable outcomes—is more readily acceptable today than it was a century ago. Both then and now, however, the special case of victim v. victim restitution seems to attract further reasoning or second thoughts. The defendant appears, not in the light of a creditor, but of a fellow victim. The argument for restitution emphasizes that the first victim's loss should not be arbitrarily shifted to a subsequent victim identically situated:

> [T]he defendant had been deceived and cheated out of his money, and had taken worthless notes therefor, and there would seem to be no reason for holding that he should be indemnified in the result of a like fraudulent deception practiced by the same impostor upon the plaintiff.[56]

But if equities were equal, there was no reason to shift the loss in the other direction either. This equitable rationale for doing nothing appears prominently in the classic case of *Concord Coal Co. v. Ferrin*.[57] An imaginative rogue named Bean had invented some sort of "appliance." (In light of what happened, Bean's invention probably had something to do with coal.) Bean asked the defendants, who were apparently machinists, to make a model of his invention, then failed to pay them for their work. When the machinists pressed for payment, Bean told them that the Concord Coal Co.

> was backing him, and that he would get the plaintiff company to furnish a ton of coal for application as payment upon his indebtedness; and the defendants agreed to accept a ton of coal in part payment. Bean thereupon informed the plaintiffs that the defendants wanted a ton of coal, without saying anything about the arrangement he had made with them. The coal was delivered to the defendants and used by them in their business.[58]

55. *Id.* at 295 (citations omitted).

56. Strauss v. Hensey, 9 App. D.C. 541, 547 (1896). *Cf.* Nat'l Shawmut Bank of Boston v. Fidelity Mut. Life Ins. Co., 61 N.E.2d 18, 22 (Mass. 1945) ("Before the plaintiff even considered making the payment to the defendant, the defendant had already lost its money, although it did not realize the fact.").

57. Concord Coal Co. v. Ferrin, 51 A. 283 (N.H. 1901).

58. *Id.* at 283–84.

When the coal company sent a bill for the coal, the machinists refused to pay; they had credited the value of the coal against Bean's debt to them. When the coal company sued in restitution to recover the value of the coal, the machinists responded that their own equitable position was just as good as that of the plaintiffs. The New Hampshire court agreed with them:

> It is contended that the plaintiffs can recover because otherwise the defendants would be unjustly enriched at the plaintiffs' expense. But that fact is not found. Both parties trusted and were deceived by Bean. If the plaintiffs cannot recover of the defendants for the coal, they have a claim against Bean for its value; while, if the defendants were obliged to pay for the coal, they would also have a claim against Bean for the same amount. It may be assumed that Bean is worthless. But there is no equitable reason why the plaintiffs rather than the defendants should be released from the consequences of their trust in Bean.[59]

In another representative decision denying restitution, the court relied principally on the conventional idea that V1 had received V2's money for what the court deemed a valuable consideration—namely, the surrender of a note given by Swindler, secured by a stolen automobile. But there was a deeper reason as well:

> If we look at this case from a purely equitable viewpoint, the result to which we must come will not be different than that above announced . . . . [I]f respondent was innocent, so was the appellant. The equities in favor of the respondent are not less great than those running with the appellant. We think the judgment of the trial court [denying restitution] was right, and it is affirmed.[60]

If two victims are identically situated, then, the question comes down to this: whether the inability to demonstrate a superior equity is more harmful to the cause of action for unjust enrichment or to an innocent recipient's defense. Judicial views were plainly divided, and either answer—indeed, the question itself—seems unsatisfactory. If the task is to decide, as courts on either side of the question have routinely assumed, "which of the innocent

59. *Id.* at 285.

60. Gaffner v. American Finance Co., 206 P. 916, 918 (Wash. 1922). The court appears to have been briefly confused about which party was the appellant, but the intended meaning is clear: "if the [claimant] was innocent, so too was the [defendant]."

parties must bear a loss caused by the forgery and fraud,"[61] and if moreover there is no equitable reason to shift a loss either one way or another, then the affirmative defense in victim v. victim cases may be simply a matter of inertia. The accepted formulation of the problem, in which a claim to recover a mistaken payment is met with some sort of defense, to be judged good or bad, means that the remedy is all or nothing. It leaves no room for the obvious possibility that between victims similarly situated, the loss should be shared. The newer post-Ponzi cases have been trying to find a way to do this.

B. *The Commingling Fictions*

The fortuitous nature of most casualty losses is an undeniable feature of human affairs, and it may seem curious that the federal courts should start trying to counteract the effects of luck and chance in this one particular set of cases. If your gold and my silver are stored side by side in the same warehouse, and a dishonest warehouseman steals proportionately more of one than of the other, subsequent adjustments will be on a net loss basis, with no one suggesting that losses be equalized between bailors similarly situated. One reason for the greater innovation in the post-Ponzi cases may be the simple fact that the property to be allocated between victims—thereby normalizing losses—is already in the hands of the court or its receiver. A court that might refuse to allow one victim to reclaim negotiable securities from Swindler's desk drawer would find it far more difficult to distribute them ratably if, for some fortuitous reason, the securities had already been restored to their previous owner.

The same practical difficulties obstruct any direct attempt to recover earlier (and disproportionate) payouts to Ponzi victims. Assume that A and B have each invested $1,000 in the same fraudulent scheme. By the time the fraud is revealed, A has already withdrawn $500, but B has withdrawn nothing. So long as A is entitled to the usual affirmative defense as creditor/payee—and thus entitled to retain the money withdrawn—a net loss allocation treats these victims very differently. Ratable allocation in proportion to original investments would necessarily deny the defense, requiring A to repay the money withdrawn and allowing the receiver to distribute the fund (so augmented) in equal shares.

Courts have perceived this possibility as a theoretical matter, but they do not pursue it, because they perceive even more clearly the difficulty of

61. *Nat'l Shawmut Bank of Boston*, 61 N.E.2d at 19.

retrieving prior distributions from their fortunate recipients. But a method of distribution adopted in some recent cases—called "rising tide" as opposed to net loss—is a half step in this direction: it works to equalize losses in proportion to original investments, but only so far as this can be done without requiring anyone to repay funds previously withdrawn. The rising tide allocation method takes a composite approach. While *A*'s withdrawals are not required to be repaid in cash, they are nevertheless counted (i) as part of the assets theoretically available for distribution and (ii) against A's ratable share of those assets (based on initial investments). Thus while A and B have a right to share equally in whatever the receiver has been able to collect, A will be treated as having already received the first $500 of his distributive share. In other words, A will forgo his 50% share of future distributions until the amount of distributions forgone by A equals $500.[62]

If ratable recovery in proportion to original losses constitutes justice between Ponzi victims, it should apply equally to the two-party case with which these questions began—in which Swindler defrauds V1, then tricks V2 into repaying V1. Accepted methods of restitution cannot achieve this result. A binary, all-or-nothing approach that either protects the repaid earlier victim as a purchaser for value, or else denies protection on the ground that value has not been given, will either shift the loss or leave things alone. Accepting this limitation leads quickly to the unattractive proposition, endorsed by the 1937 *Restatement*, that these cases are decided by technical rules to which considerations of justice are irrelevant.

To recapitulate: the money originally paid by V1 to Swindler is gone forever; the money paid by V2 to V1 is sitting in V1's bank account; and

62. *See* Kull, *supra* note 1, at 306–12, for a closer description of "rising tide" distribution. Rising tide is described in cases as if it were an equitable improvisation, based purely on a receiver's sense of fairness, but it finds a close analogy in an established technique of trust administration known as "equitable recoupment." If we accept the starting proposition about the Ponzi victims' relative entitlements—that they are fixed by reference to initial investments rather than net losses—then a victim who has received a prior distribution from the scheme resembles a trust beneficiary who has been paid more than his rightful share of trust income. When a trustee has overpaid one of several beneficiaries, and there remain trust assets for future distribution, the authorities recognize a doctrine whereby (i) the overpaid beneficiary may or may not be affirmatively liable to restore the overpayment—certainly not, if he has changed position—but (ii) the amount of the overpayment may at any rate be recouped, so far as possible, by deduction from his share of future distributions. RESTATEMENT (SECOND) OF TRUSTS § 254 cmt. a (AM. LAW INST. 1959); *see* 4 AUSTIN WAKEMAN SCOTT ET AL., SCOTT & ASCHER ON TRUSTS § 25.2.4 at 1848 (5th ed. 2007) (absent change of position, "there is no reason why the [overpaid] beneficiary should be permitted to profit at the expense of . . . the other beneficiaries").

there is no other money to argue about. Existing rules tell us that this residue of Swindler's fraud belongs to one victim or the other—depending on whether V1 has an affirmative defense or not. To share losses between V1 and V2 it is necessary to recharacterize the ownership of *both* victims' funds. The necessary rule is one by which assets entrusted to Swindler—whether by V1, V2, or Vn, and whether traceable or not—become, from that moment on, part of a commingled fund belonging to all victims in proportion to their contributions.

Such a rule would work an unthinkable alteration to ordinary property concepts, except that—on the story presented here—it is a rule toward which the recent Ponzi cases have been moving. It is the rule already being applied when a court refuses to allow a fraud victim to retake identifiable property, and it is the proposition underlying the rising tide or "recoupment" half-step.

The problem arises in an area where ownership already depends, in important instances, on equitable modifications of legal rules. Suppose that V2's funds—instead of being paid over to V1—are paid instead into Swindler's bank account, where there is a pre-existing balance of Swindler's own funds. Swindler then withdraws and dissipates half. By ordinary legal logic, V2's interest in Swindler's bank account could only be an undivided fraction of the combined balance, and his funds must, therefore, have been diminished *pari passu* by Swindler's dissipation. The result is otherwise, but only because the legal logic of ownership has been modified, by main force, to do justice between a wrongdoer and his victim. The first and most important of the tracing fictions, known as "the rule of Jessel's Bag," imposes a presumption that when a wrongdoer combines money of a victim with money of his own, then spends part of the commingled fund, he is spending his own money first—giving the victim first claim on whatever remains in the account.[63] The presumption has nothing whatever to do

63. Knatchbull v. Hallett *(In re Hallett's Estate)*, 13 Ch. D. 696, 727–28 (Ct. App. 1880). The rule is named for the following passage in the opinion of the Master of the Rolls, Sir George Jessel:

> The simplest case put is the mingling of trust moneys in a bag with money of the trustee's own. Suppose he has a hundred sovereigns in a bag, and he adds to them another hundred sovereigns of his own, so that they are commingled in such a way that they cannot be distinguished, and the next day he draws out for his own purposes £100, is it tolerable for anybody to allege that what he drew out was the first £100, the trust money, and that he misappropriated it, and left his own £100 in the bag? It is obvious he must have taken away that which he had a right to take away, his own £100.

Id. at 727.

with the facts and usually flies in their face. It permits an artificial identification of what is, in reality, unidentifiable.

A rule by which assets contributed by fraud victims become, from that moment, part of a commingled fund, belonging to all victims as a class, is like Jessel's Bag in reverse. Instead of a tracing fiction, it is a commingling fiction, imposing a presumptive confusion of assets that, in reality, remain identifiable. Instead of justice between victim and wrongdoer, it pursues justice between the wrongdoer's victims *inter se*. It may be objected that the equities between fraud victims are not nearly so obvious as the equities between a wrongdoer and his victim. This takes us back to the starting point, where the question is whether net loss or initial investment is the proper baseline for the victims' relative entitlements. But if the recent Ponzi decisions are right about the equities of victim v. victim restitution, their commingling fictions do no more violence to property rules than the established tracing fictions—equitable modifications that it would now seem hard to do without.

IV. CONCLUSION

Decisions that refuse to permit a dispossessed owner to retake identifiable property may at first appear lawless. They disregard what courts, until recently, would have understood to be coherent and binding authority in an area of the law—that of equitable rights and remedies—that has become less familiar to the U.S. legal profession. If the outcomes are seen as desirable nevertheless, they might be thought to illustrate Holmes's wonderful apothegm that "[i]gnorance is the best of law reformers."[64]

It is true that the courts in these cases do not acknowledge—indeed, they seem to be unaware of—the doctrinal obstacles to what they are doing. But the departure from legal rules in deeming identifiable property to be "commingled" is arguably no more radical than that of Sir George Jessel in deeming commingled funds to be identifiable. In his ability to introduce such a departure, the Master of the Rolls enjoyed important advantages over modern judges. Beyond a comprehensive and confident command of equity jurisprudence, he had the advantage of a conceptual starting-point that has been largely lost to modern American law. This is the idea that equity is different; that legal rules do not necessarily apply in equity; and that the power to supplement or modify legal outcomes is the chief reason why equity exists.

64. O. W. HOLMES, JR., THE COMMON LAW 78 (1881).

The reporters of the 1937 *Restatement of Restitution* chose to paper over well-known doubts about the extent to which commercial rules about antecedent debt, renamed "discharge for value," should apply outside an ordinary business setting. Few courts since then have shown any inclination to revisit the question; the *Restatement (Third)*, published in 2011, missed an important opportunity to describe a more nuanced rule.[65] Seen against this background, the departure from authority by some courts and receivers in recent Ponzi cases may be a sign of fresh equity thinking. The fact that their opinions make no attempt to situate the new outcomes within established doctrine has simultaneously enabled and disguised these interesting developments.

65. The most important modern decision to reject "discharge for value" is probably *Wilson v. Newman*. Wilson v. Newman, 617 N.W.2d 318 (Mich. 2000). The new *Restatement* pointed to *Wilson v. Newman* to acknowledge a contrary line of authority, but did not otherwise depart from Seavey and Scott. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 67 rep. n. b (AM. LAW INST. 2011). The failure in 2011 to suggest any significant qualification to the mechanical rule of 1937 was a regrettable lapse by the reporter.

